



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

INTERNAL REVENUE SERVICE
Director, Exempt Organizations

DEPARTMENT OF THE TREASURY
P. O. Box 2508 - TEGE: EO
Cincinnati OHIO 45201

Date: [REDACTED]

Employer Identification Number:
[REDACTED]

Person To Contact:
[REDACTED]

Contact Telephone Number:
[REDACTED]

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code. Based on the available information, we have determined that you do not qualify for the reasons set forth in enclosure 1.

Because your organization has not established exemption from Federal income tax under Internal Revenue Code section 501(c)(7), it will be necessary for you to file an annual income tax return Form 1120. Contributions to you are not deductible under Code section 170.

If you agree with our proposed denial, please sign and return one copy of the enclosed Form 6018 Consent To Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal which gives the facts, the law, and other information to support your position as explained in the enclosed Publication 892 Exempt Organizations Appeal Procedures For Unagreed Issues. Your appeal must be submitted within thirty days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date. The hearing may be held at the Regional Office or, if you request, at any mutually convenient main Internal Revenue Service Office. If you are to be represented by someone who is not one of your principal officers, that person must file a proper power of attorney and otherwise qualify under our Internal Revenue Service Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If you do not provide the requested information, it will be considered by the Internal Revenue Service that you have not taken all reasonable steps to secure the determination.

If you do not agree with these conclusions, you may within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. The enclosed Publication 892 gives instructions for filing a protest. If you desire an oral discussion of the issue, please indicate this in your protest.

[REDACTED]

This proposed determination will become final if you do not file a protest with this office within 30 days of the date of this letter.

We have sent a copy of this letter to your representative as indicated in your power of attorney.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

[REDACTED]

Director, Exempt Organizations
Rulings and Agreements

Enclosures:
Enclosure.1
Form 6018
Publication 892

Enclosure I
Reasons for Proposed Adverse Action

FACTS:

[REDACTED] incorporated you in the State of [REDACTED] on [REDACTED]. Your board of directors upon incorporation consisted of [REDACTED]. Your purpose stated, "The Corporation is organized as a non-profit making private club. The purpose therefore is social."

Your by-laws indicate that the Board of Directors shall admit members and that an affirmative vote of two-thirds of the Directors shall be required for admission. The by-laws further state that members of any class(es) entitled to vote shall have one vote on each matter submitted to a vote of the members. The by-laws indicate an annual meeting of members shall be held to elect directors and transact business. A quorum for a meeting is one-tenth of the members. You have stated that there are no fees for membership. Your application indicates that any customer of the legal age of 21 is eligible for membership.

The by-laws state that the business and affairs of the Corporation and all corporate matters shall be exercised by or under authority of the Board of Directors that will consist of three, and that election for all Director positions, vacant or not, shall occur at each annual Members' meeting. Further, the by-laws state that none of the directors need be members.

You entered into a Management and Sublease Agreement on [REDACTED], with [REDACTED] (hereafter referred to as "[REDACTED]") to provide management services and a facility to you. The term of the Agreement is one year, but the Agreement will automatically extend and exist indefinitely if not terminated. You will compensate [REDACTED]% of gross revenues for services of alcoholic beverages, for provisions of specified services, equipment, and supplies. You will compensate [REDACTED]% of gross revenue for services of alcoholic beverages. [REDACTED] is entitled to all income from food service and may bill you for your share of promotional expenses and advertising. You are the only management client of [REDACTED].

On your application for exemption, you described your activities as "The serving of alcoholic beverages to club members to promote socialization and relaxation. This service is provided on a daily basis: Monday-Friday from 11 AM to 2 AM and Saturday & Sunday from 3:30 PM to 2 AM." You indicated you currently have [REDACTED] members. Prospective members are given temporary membership status at the time they make application. The membership committee then reviews the applications and approves qualified applicants within three days. The application information collected consists of name, address and signature. The applicant signs a statement that reads, "I agree to abide by the club's rules. I give this club permission to use my driver's license number for the sole purpose of maintaining my correct address for club records, as required by State law. I have received a copy of this agreement." Memberships automatically expire at the end of one year. Your facility accommodates [REDACTED] persons.

[REDACTED]

Minutes of the [REDACTED] annual meeting were provided. The minutes refer to the shareholders and directors annual meeting. Minutes reflect only [REDACTED] being present. They agreed to continue the Agreement with [REDACTED] and that no change in the board of directors or officers would be made until such time that a change in ownership may take place within the corporation. There were also minutes where the three approved a membership committee consisting of eight individuals.

You provided samples of advertising that you stated appear in local and student newspapers and leaflets. Only one of the ads indicates a membership requirement and it indicated that only members could buy alcohol. Your approximate annual advertising budget is \$[REDACTED].

LAW:

Section 501(c)(7) of the Internal Revenue Code provides for exemption of clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Revenue Ruling 58-588, 1958-2 CB 265 provides that an organization formed by several individuals to operate a health, recreational, and social club but whose predominant activity is the selling of services for profit to an unlimited number of so-called "members", who have no voice in the management of the club and whose only rights are to the use of the club's facilities upon the payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Internal Revenue Code.

Revenue Ruling 58-589, 1958-2 CB 266 provides criteria or tests for determining whether an organization qualifies for exemption as an organization described in section 501(c)(7) of the Code. It states that there must be an established membership of individuals, personal contacts and fellowship. A commingling of the members must play a material part in the life of the organization.

Revenue Ruling 66-360, 1966-2 CB 228 provides that when a national sorority is created and controlled by a business corporation engaged in furnishing services and supplies to the sorority and its member chapters, neither the sorority nor its chapters can qualify for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code. The business corporation controls the sorority and member chapters by reason of its control over the national sorority's governing body. The corporation uses this control to carry on a commercial enterprise consisting of furnishing services and supplies to the national sorority, its chapters, and individual members. Collection of national membership fees is enforced by the power of the executive council to withdraw national membership privileges from delinquent members.

APPLICATION:

Your operation is like that of a typical commercial bar as to activities at the facility and advertising to the public. Membership is open to anyone of drinking age, thus, you are open to the general public. Thus, you are operating a business to the general public and would not qualify for exemption from Federal income tax according to section 1.501(c)(7)-1 of the Regulations as cited above. Like the organization in Rev. Rul. 58-588 you have "so-called members" who have no real voice in your operation as shown by your minutes, the fact that memberships expire every year, and you operate a business to the general public.

You have over [REDACTED] members while having a facility that will accommodate only [REDACTED] persons. Your only membership requirement is that individuals are of drinking age. You collect very little data on members and charge no membership dues. You advertise to the general public with most of the advertising not indicating you have a membership requirement. Your memberships automatically expire at the end of a year. Thus, you fail to have an established membership since membership ends every year and you fail to meet the commingling requirement since the large numbers of members make it unlikely that there is a material commingling of all members. Therefore, you would not meet the requirements for qualification as specified in Rev. Rul. 58-589.

Your formation by the same individuals with whom you have a Management and Sublease Agreement without other member involvement shows that you were formed for the private benefit of [REDACTED]. In fact, the agreement was approved even before you were incorporated. Although you indicate you have members who have voting rights, minutes of the annual meeting indicate only the three owners of [REDACTED] as being present and voting even though your by-laws specify a quorum of members must be present and vote. The minutes identified the three individuals as your shareholders. This shows that you are operated for the private benefit of a for-profit entity as in Rev. Rul. 66-360 and would not qualify for exemption.

Accordingly, based on these facts and circumstances, we conclude that you are not exempt as described in section 501(c)(7) of the Code.

TAXPAYER POSITION:

Your position was stated as, "We believe the organization does have as its main purpose the providing of social activities for its members. [REDACTED] is a for profit entity, providing its services with the goal of allowing its owner/operators to receive reasonable compensation for their services and use of their facilities. This, however, is no different than any individual paid manager or landlord. The location of the club at the college campus causes it to have a stable, but revolving membership to whom the social benefits of membership are seen as more than just the availability of food and drink." You stated also, "The social activities engaged in by the members include informal social intercourse with other members while enjoying available food and drink, group TV viewing of sporting events, playing of video games and participation in special events organized by the club."

[REDACTED]

CONCLUSION:

You did not cite any allowable published precedents to support your position, only your belief that you are a social club that should qualify under section 501(c)(7) of the Code. The application of the tax law as stated above remains and shows that you do not qualify for exemption under section 501(c)(7) of the Code.